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INFO RUEHMO/AMEMBASSY MOSCOW 2430
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RUEHRA/AMEMBASSY RIGA 2768
RUEHVL/AMEMBASSY VILNIUS 6534
RUCPDO/DEPT OF COMMERCE WASHDC
RUEHBS/USEU BRUSSELS

C O N F I D E N T I A L TALLINN 000835

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STATE PASS USTR FOR LAURIE MOLNAR, EUR/NB AND EB/CBA
COMMERCE FOR 4212/MAC/OECA/LMARKOWITZ
HELSINKI FOR SCO MCCLEARY
RIGA FOR BABB
VILNIUS FOR WOODARD

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TAGS: [ECON](#) [PREL](#) [EFIN](#) [KIDE](#) [EN](#)
SUBJECT: GOE AND BRS CLOSE TO A DEAL ON RAILWAY SALE

REF: A) TALLINN 373 B) TALLINN 437

Classified By: DEPUTY CHIEF OF MISSION JEFFREY GOLDSTEIN FOR REASONS 1.
5(b) AND (d)

¶1. (C) SUMMARY: The GOE and Estonia Railway's (ER) primary shareholder, Baltic Rail Services (BRS) may be close to concluding a deal for the buyback of BRS' shares. The Ministry of Economy (MOE) appears prepared to take a more flexible approach on price. BRS and ER are anxious to close a deal, but only if the GOE meets conditions related to price, negotiation, and public relations. Otherwise, BRS claims it can ride out the international arbitration and local court cases it has filed against the GOE. Prospects for resolution of this case appear better now than they have for months.
END
SUMMARY

SIGNS OF PROGRESS

¶2. (U) After weeks of relative quiet on the railways issue, the GOE announced on September 7 that it is prepared to buy back the 66% stake in Estonian Railways (ER) held by U.S.-led investor Baltic Rail Services (BRS). The MOE recommended Suprema Investment Bank as the government's negotiator with BRS. ER Chairman Chris Aadnesen told us that he sees this as a positive sign that the GOE is serious about concluding the deal quickly and amicably, as BRS has also chosen Suprema to represent its interests in this matter.

¶3. (C) Share price has been the main sticking point between the parties since BRS indicated last year that it was interested in selling its shares. The GOE had originally offered BRS EEK 2.1 billion (USD 172 million). However, recent public statements by Ministry of Economy officials appear to indicate greater GOE flexibility on this issue. When we contacted MOE for input, Minister of Economy Edgar Savisaar's aide, Heido Vitsur, said that "Price is the only issue." For its part, BRS has remained adamant about getting its EEK 2.6 billion (USD 213 million) asking price. Aadnesen said that even if the parties publicly announce a "compromise price" of about EEK 2.4 billion (USD 196 million), BRS will still demand the difference be paid to them more discretely through another financial vehicle, such as an additional

dividend authorized by ER to its shareholders. In this way, BRS would still get its desired sale price.

¶4. (C) Aadnesen told Econoff that, in addition to agreement on price, ER and BRS will demand that the GOE meet three other conditions, in order to conclude an agreement. First, the deal must be phrased in the press as a "repurchase" of BRS shares, not as a cancellation of the 2001 privatization agreement, which would imply that BRS had breached this agreement. The GOE must publicly describe the deal as an amicable one. Second, the GOE must empower a negotiator with power of attorney to act on behalf of the GOE to avoid any ambiguity as to full government consent to the deal. Finally, the GOE must agree to drop all outstanding lawsuits against BRS.

DEAL OR NO DEAL?

¶5. (C) ER'S Aadnesen and BRS President Edward Burkhardt have responded positively to GOE overtures on repurchase of BRS sales. It appears that both will be happy to resolve this dispute sooner rather than later, as long as BRS can get its desired price. They contend that the GOE is finally ready to come to the table because it now realizes it is likely to lose the pending arbitration and court cases BRS has filed in Stockholm, Tallinn and the International Court for Settlement of Investment Disputes (ICSID) in Washington, DC. Aadnesen and Burkhardt have consistently said they would be willing to wait out the results of these cases and are confident they would win if they are allowed to run their full course. They estimate that success in arbitration could result in up to an additional EUR 80 million for BRS - in awards of back fees due for track access charges currently kept artificially low by the GOE. Therefore, the longer repurchase negotiations draw out and the farther along the arbitration cases get, the less likely BRS will be willing to sell its shares. According to Aadnesen, BRS plans to give the GOE 30 days from the time they get a serious offer to actually make a firm commitment in writing. After that, the rest of the deal could be finalized on a slightly longer timeline.

¶6. (C) Further, Aadnesen said that ER has been actively investigating corruption in the MOE (the key GOE ministry in this case), led by Center Party leader Edgar Savisaar. Aadnesen claims that this investigation has implicated Savisaar, ex-GOE officials now serving on the ER board, and SeverstalTrans, one of the main Russian customers and competitors of the railway, which has been acting in Estonia through its subsidiary SpaceCom. Aadnesen told us that ER has assembled this evidence into a report that ER was prepared to release publicly to opposition parties. However, ER now says they will refrain from releasing the report if an amicable sale is truly imminent. Aadnesen claimed that the evidence uncovered in ER's report "would bring down the government in most countries". He alleges that it is symptomatic of a larger pattern of behavior by Russian-backed companies operating in the energy and transport sectors throughout the Baltics with the ultimate aim of bringing Estonia, Latvia and Lithuania effectively under Russian economic, if not political, hegemony.

COMMENT

¶7. (C) It has been clear since June, when the government failed to act on its threat to revoke the Railway privatization agreement, that the Ministry of Economy has been rethinking its confrontational approach. Right now the

timing

may be right for both sides. As noted above, BRS' desire to take the bird in the hand of an amicable sale has a limited shelf life. At the same time, having promised to bring the Railway back under state control, Savisaar has an incentive to deliver before the parliamentary election campaign begins after the New Year. Moreover, Estonia's large budget surplus would provide the means for, and limit the political damage of, agreeing to pay BRS' higher price.

18. (C) Aadnesen and Burkhardt have long held that Savisaar is in the pay of Severstal. While we have no idea what evidence BRS has gathered, they would be well advised to use great caution in seeking to use it as a lever. Savisaar has survived any number of scandals in his colorful political career, and thrives on conflict and the perception on the part of his electorate that he is being picked on by the rest of the political elite.
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